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November 10, 2022
Report 2021-806

FACT SHEET

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City of Richmond

Anticipated Deficits, High Pension Debt, and Mismanagement of Its Housing Authority Cause the City to Be High Risk

Summary

Richmond has a long-standing history of financial challenges, which contributed to the State Auditor's Office rating it as at high fiscal risk from fiscal year 2016–17 through fiscal year 2019–20. In our most recent local high-risk dashboard assessment, Richmond demonstrated some improvement in certain risk indicators—moving from the 9th to the 10th California city at greatest risk. However, Richmond retains many high-risk characteristics, including the risk of significant projected deficits, which may critically deplete its reserves. In fact, Richmond's projections—which may be too optimistic—indicate that it may have less than two weeks of expenses in reserve by fiscal year 2027–28. The risks Richmond faces and the totality of our audit findings led us to designate Richmond as high risk.

Key Risks

Despite recent improvements, Richmond's long-term financial stability remains uncertain.

- Richmond forecasts a significant long-term deficit, which recent financial trends may worsen.
- The city's debt burden remains high at $250 million as of June 2021.

Addressing its poorly funded retirement benefits and below-market employee compensation will increase Richmond's expenses.

- Richmond's retirement costs were more than $35 million in fiscal year 2020–21, almost a quarter of its $162 million in general fund expenditures for the year. CalPERS anticipates that the city's annual pension costs will increase to $53 million by fiscal year 2028–29.
- Increased expenses related to cost-of-living adjustments to employee wages—which Richmond deferred for up to seven years—will result in additional costs to the city.

The city has mismanaged the Richmond Housing Authority for a decade.

- As a result of numerous instances of mismanagement, the federal government is directing the housing authority to transfer its direct public housing responsibilities to other entities.
- The authority has missed 11 of 26 deadlines associated with this transfer of responsibilities.

Risk Designation:
HIGH RISK

- *Population:* ***116,000***
- *Median Household Income:* ***$72,463***
- *Unemployment Rate:* ***8%*** *(annual average 2021)*

- The housing authority may owe $1 million or more in federal taxes and penalties.

The city has not consistently followed its contracting policies or updated its fees.

- In at least two instances, Richmond could not demonstrate that it followed its own procurement policies, or it made errors or omissions that could affect its management of contracts.
- The city has not updated its fee schedules as required, and it risks incurring costs for services its fees should cover.

Key Recommendations

Richmond should do the following:

- Review the city's reserve policy and determine whether a higher target is appropriate.
- Propose actions that would help ensure balanced budgets and eliminate projected deficits.
- Implement policies for funding its pension and retiree benefit trust funds.
- Devote sufficient resources to the housing authority to resolve all past-due requirements and meet remaining deadlines to comply with the agreement to transfer public housing responsibilities to other entities.
- Resolve the housing authority's past tax liabilities and prevent unnecessary new liabilities.
- Comply with its municipal code and contracting policies when entering into contracts.
- Determine a cost-effective frequency to update its fee schedules to reflect all allowable costs.

City of Richmond

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November 10, 2022
2021-806

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

Despite recent financial improvements, the city of Richmond's long-term financial stability remains uncertain. Our office's audit of the city—conducted as part of our high-risk local government agency audit program—concludes that the city is high risk due to its anticipated deficits, high pension debt, and mismanagement of the Richmond Housing Authority (housing authority).

Richmond forecasts a significant long-term deficit, which we believe may worsen based on emerging financial trends. The city anticipates that these deficits may average as much as $6.7 million annually beginning in fiscal year 2023–24 and continue through at least fiscal year 2027–28. Despite having increased its general fund reserves to nearly $49 million in fiscal year 2021–22, Richmond projects that its deficit will deplete those reserves to less than $9 million by fiscal year 2027–28, which is well below levels recommended by financial experts.

Richmond's growing annual pension costs are a significant barrier to balancing its budgets. In fiscal year 2020–21, Richmond paid $37 million in pension costs. However, these costs could reach $53 million by fiscal year 2028–29. Richmond attempted to mitigate its pension costs in 2005 by issuing $115 million in bonds and investing the proceeds but, after refinancing those bonds in 2022, the city now expects its residents to pay millions in annual debt service until 2044.

Finally, the mismanagement of Richmond's housing authority has resulted in the federal government disallowing millions of dollars in reimbursement of city expenses and requiring the housing authority to transfer its public housing responsibilities to other entities. However, the housing authority has missed numerous federal deadlines associated with this transfer and the city, which provides staff and financial support to the housing authority, may need to provide additional resources to resolve this ongoing problem.

Respectfully submitted,

MICHAEL S. TILDEN, CPA
Acting California State Auditor

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HIGH-RISK ISSUES

City of Richmond, Contra Costa County

Risk Designation: **High Risk**

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Risks the City of Richmond Faces

Although Richmond's general fund reserves have increased in recent years to the point where it has reserves in excess of two months of general fund expenditures, its long-term financial stability remains in question. Its 2022 financial forecast predicts annual deficits that will grow to $13.8 million in fiscal year 2025–26 before shrinking to $9.4 million by fiscal year 2027–28; these deficits threaten to critically deplete the city's general fund reserves. Further, Richmond's current forecast may be underestimating inflation and does not account for the possibility of a recession in the later years of the projection. If Richmond eventually exhausts its reserves and spends more than it projects, it will need to either raise revenue or cut city expenditures or services. Our Local Government High-Risk Dashboard (dashboard), which we updated in October 2022, identified five areas—debt burden, pension obligations, pension costs, future pension costs, and other post employment benefits (OPEB)—in which the city's finances continue to have high risk ratings as indicated in Table 1. Although we determined that Richmond's overall fiscal risk rating for fiscal year 2020–21 was moderate and adjusted its ranking among the highest-risk cities from 9th to 10th, we conclude that Richmond is high risk based on the totality of factors described in this audit report, particularly its projections of future deficits.

Table 1
Richmond's Fiscal Risk Indicators Have Improved

FINANCIAL INDICATOR	2018–19	2019–20	2020–21
Overall Risk Rating	High Risk	High Risk	Moderate Risk
General Fund Reserves	HIGH	HIGH	MODERATE
Debt Burden	HIGH	HIGH	HIGH
Liquidity	LOW	LOW	LOW
Revenue Trends	MODERATE	MODERATE	MODERATE
Pension Obligations	HIGH	HIGH	HIGH
Pension Funding	MODERATE	MODERATE	LOW
Pension Costs	HIGH	HIGH	HIGH
Future Pension Costs	HIGH	HIGH	HIGH
OPEB Obligations	MODERATE	LOW	LOW
OPEB Funding	HIGH	HIGH	HIGH

Source: Analysis based on Richmond's audited financial statements and CalPERS' actuarial reports.

Addressing the areas in which Richmond continues to be at high risk and counteracting the effects of its long-term wage freezes will increase the city's expenses. Notably, the California Public Employees' Retirement System (CalPERS) has projected Richmond's annual retirement costs to increase from roughly $35 million in fiscal year 2020–21 to $53 million in fiscal year 2028–29. These increasing costs are a potential barrier to the city's ability to maintain balanced budgets. As of June 2021, Richmond has funded its OPEB trust funds—which assist the city in meeting health care obligations for retired staff—at about 27 percent of the cost of its promised future benefits and has set aside more than $7 million in fiscal year 2022–23 for increasing staff salaries and benefits that it had previously frozen to reduce costs. However, maintaining salary increases may prove difficult as the city moves closer to deficit spending.

Richmond's mismanagement of the Richmond Housing Authority (housing authority)—a legally separate entity created to manage low-income housing facilities—has also increased financial risk to the city. Audits by the U.S. Department of Housing and Urban Development (HUD) noted deficiencies in financial practices, oversight, documentation, and accountability. In fact, in 2016 HUD found that the housing authority had misled HUD on the status of its finances and had submitted falsified documentation. In its report, HUD noted that the housing authority had inappropriately allowed the city to use HUD funds, the city had charged the housing authority excessive amounts for rent and services, and the city's actions had resulted in more than $2 million in misspent HUD funds.

The housing authority signed an agreement with HUD in 2019 with the intent, according to HUD, to effectuate the transfer of the housing authority's direct public housing responsibilities to other entities, such as developers, who will rehabilitate the properties and hold long-term leases to use them for public housing. Richmond acknowledged this agreement through the signature of its mayor and agreed to work in good faith to assist the housing authority and HUD in accomplishing the tasks described in the agreement. However, the housing authority has missed 11 of the 26 deadlines and not completed the associated tasks needed to make this transfer, many by more than a year. As a result, some low-income housing residents have experienced delays in the rehabilitation of their housing. Although the housing authority is a legally separate entity from the city, the city agreed to assist the housing authority with the agreement; thus, continued concerns related to the housing authority may require additional financial resources from the city.

Richmond has also not consistently followed its policies for contracting and fees. We examined 10 of Richmond's contracts and found at least two instances in which it failed to follow contracting policies or made errors involving contract management. For example, Richmond did not justify its use of an alternative contracting process on a $24,500 contract because it failed to make a formal determination that using this alternative process was in the city's best interest, as it is required to do. Richmond has also not consistently updated its fees to reflect the cost of doing business, thereby forgoing revenues that could help improve its financial condition.

Recommendations

The following are the recommendations we made as a result of our audit. Descriptions of the findings and conclusions that led to these recommendations can be found in the sections of this report.

- To help ensure that Richmond maintains appropriate reserves for times of fiscal uncertainty, city staff should complete a review by June 2023 of Richmond's reserve policy to determine whether a higher reserve target is appropriate. As part of the review, staff should consider all the factors the Government Finance Officers' Association (GFOA) recommends for setting a reserve target. Once that review is complete, city staff should present proposals to the city council for modifying the city's policy.

- To decrease the risk that Richmond will deplete its reserves, city staff should present by June 2023 to the city council a list of proposed budget actions that would help ensure balanced budgets and eliminate projected deficits.

- Richmond should include multiple scenarios in its financial projections, including scenarios with potential additional risks, such as economic downturns or recessions, and how the city would continue to fund its operations under those circumstances.

- To ensure that Richmond is able to fund its retirement-related costs, city staff should propose by June 2023 to the city council a specific policy regarding funding of its pension trust fund for this purpose. Staff should report to the city council on the estimated long-term savings from increasing its direct payments to CalPERS as compared to investing the same amounts in its pension trust fund. Staff members should use this information to inform their recommendations related to funding targets for the pension trust fund and should consider recommending that the council increase the city's payments directly to CalPERS.

- To improve the city's ability to pay OPEB, Richmond should implement, by June 2023 a policy identifying funds, such as surpluses or one-time revenues, that should be contributed to the OPEB trust fund. Staff should then conduct an annual analysis to determine whether any funds available to the city are applicable under the city's policy and should present a proposal to the city council to apply those funds to that trust fund.

- To mitigate the costs of increasing salaries, the city should perform a workforce analysis by June 2024. Based on the results of the analysis, the city council should consider eliminating vacant positions that it deems no longer necessary. Additionally, the city should continue to assess its need for any vacant position before it seeks to fill it.

- To ensure compliance with federal requirements, Richmond should dedicate the resources necessary to provide all records needed for an independent auditor to complete all outstanding single audits of the housing authority within the next fiscal year.

- To comply with existing legal obligations, Richmond should make available sufficient resources to enable the housing authority to resolve all past-due requirements of the recovery agreement and to meet the remaining deadlines in a timely manner, but no later than January 2024.

- To define Richmond's responsibility related to the housing authority, the city should immediately enter into a written agreement with the housing authority defining each entity's financial responsibilities and it should draft plans to resolve past tax liabilities and prevent unnecessary new liabilities.

- To ensure that Richmond is receiving the best value when entering into contracts, city staff should immediately begin documenting that they are following the contracting requirements in the city's municipal code and in the contracting policies for all contracts.

- To reduce potential errors and omissions by city staff members when contracting for goods and services, by January 2023, Richmond should require its finance department to create a comprehensive checklist of required documentation for contract files that other departments must follow when conducting procurements.

- To ensure that city fees appropriately cover the cost of providing services, by June 2023, Richmond should determine a cost-effective frequency for updating its Master Fee Schedule (fee schedule) to reflect all allowable costs, including adjusting fees for inflation as appropriate. Richmond should then revise its municipal code as necessary.

Agency Comments

Richmond agreed with our recommendations. We look forward to receiving Richmond's corrective action plan by January 2023 to understand the specific actions it has undertaken, or plans to take, to address the conditions that led us to designate it as high risk.

Introduction

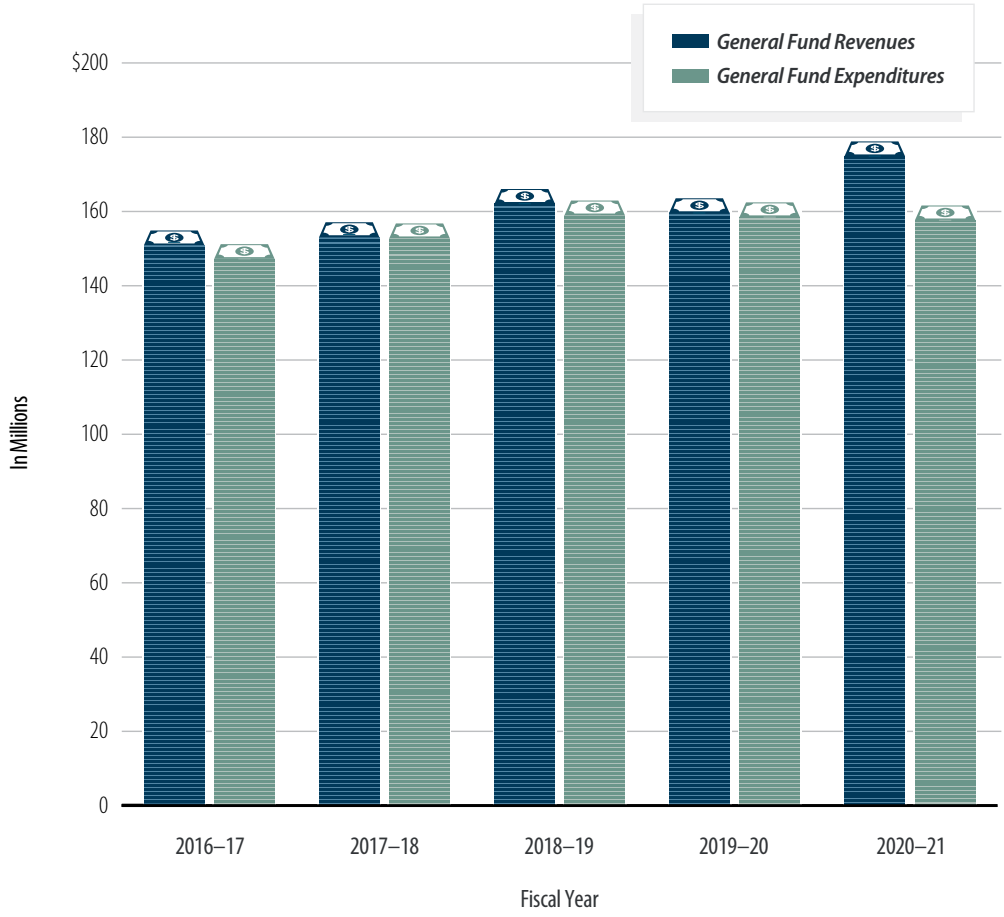
The city of Richmond, located in Contra Costa County, had approximately 116,000 residents in 2021 and about 690 full-time, budgeted employees. Richmond is a charter city and therefore has authority over its municipal affairs, and it may establish certain local ordinances beyond those that state law allows for cities that operate under general law. Voters elect a seven-member city council. The mayor is elected separately and is one of the council members. The council in turn appoints a city manager, who implements council policy and acts as the chief executive and administrative officer of the city. Richmond provides many services to residents, including libraries, parks, community facilities, and public safety.

Richmond has had a long-standing history of financial challenges. For example, in 2004 our office audited the city and found that it had drained its financial assets and jeopardized its financial stability by failing to control spending while its revenues decreased. In 2015 Moody's, a credit rating agency, downgraded the city's credit rating, citing $396 million in combined governmental and enterprise debt. Further, our dashboard has assessed Richmond as having high fiscal risk every year from fiscal years 2016–17 through 2019–20. Richmond showed some improvement in our most recent analysis of its fiscal health for fiscal year 2020–21.

Despite its challenges, since fiscal year 2016–17, Richmond has received more general fund money than it has spent, as indicated in Figure 1. General fund revenue comes in part from property taxes and sales taxes, and it funds the city's core government services, including public safety, recreation, and administration. In fiscal year 2020–21, Richmond had general fund revenues of $179 million and expenditures of $162 million. As of June 2021, the general fund had a total balance of $49 million, $35 million of which made up the city's reserves. The city estimates that it received $194 million in revenues and spent $166 million out of the general fund in fiscal year 2021–22.

In addition to its other responsibilities, the city operates a number of businesslike activities. One such program is the Richmond housing authority, a separate legal entity created in 1941 to manage low-income housing facilities. Members of the city council serve on the housing authority's board and the Richmond finance department manages the authority's finances. Currently, the housing authority directly administers more than 240 low-income housing units across two properties. The housing authority receives about 40 percent of its $4.8 million in revenues from the federal government and about 16 percent from the city. As we detail later in this report, HUD found that the housing authority mismanaged its financial operations and that its external auditor had not completed several years of audits because of staff turnover and inadequate recordkeeping within the finance department.

Figure 1
Richmond's General Fund Revenues Have Slightly Exceeded Expenditures in Recent Years



Source: Richmond's audited financial statements.

Despite Recent Improvements, Richmond's Long-Term Financial Stability Remains Uncertain

Financial Reserves Have Increased, but Risks Remain

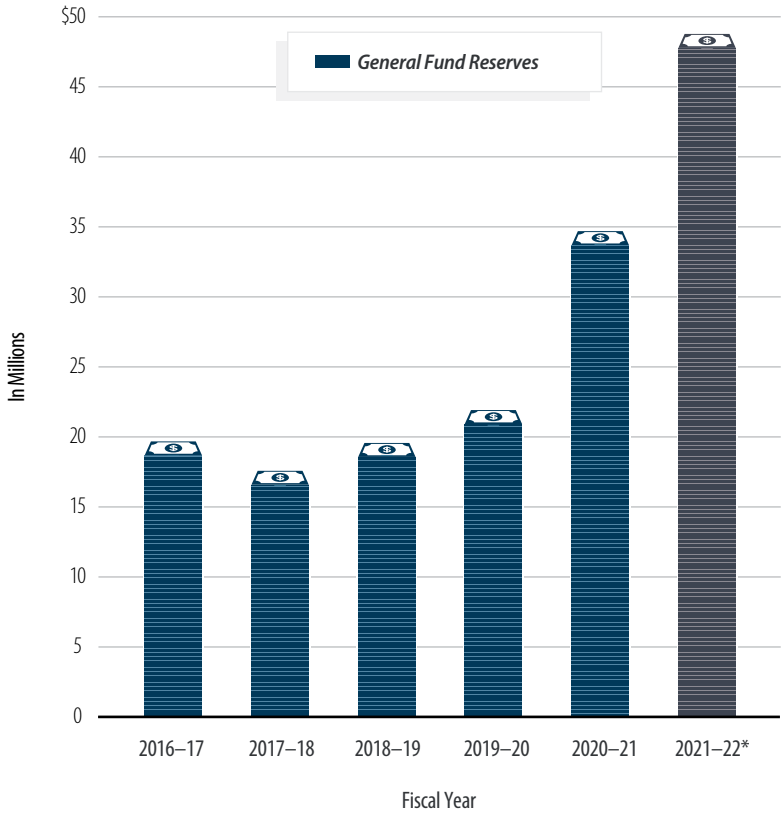
In June 2021, Richmond reached $34.7 million in general fund reserves, exceeding the minimum amount experts typically recommend. The city further estimates based on unaudited information that, as of October 2022, its reserve has since increased to almost $49 million. The GFOA recommends that a general-purpose government establish a policy to maintain an unrestricted general fund balance that would at least cover a minimum of two months—or about 17 percent—of its regular general fund operating revenues or expenditures. Richmond's general fund reserve policy substantially aligns with the GFOA recommendation. The policy requires the city to maintain a minimum of 15 percent of the next year's budgeted general fund expenditures as its reserve. Richmond's 2021 unrestricted fund balance represented more than 19 percent of its fiscal year 2020–21 general fund expenditures,[1] exceeding the GFOA's minimum recommendation. Richmond was able to reach this general fund balance partly through revenues that are unlikely to be repeated regularly, such as unexpectedly high property transfer taxes.

The city's current reserve represents significant growth from prior years. For example, in June 2018, Richmond only had $17.7 million in reserve, just 11 percent of its expenditures. For fiscal year 2019–20, we considered the city's reserve level a high risk because it maintained low general fund balances compared to its expenditures and transfers, and it had had limited growth in its reserves in previous years. However, the city's improved balance, illustrated in Figure 2, led to our updated determination that reserves are now an area of moderate risk for the city as of October 2022.

That said, Richmond may require a higher reserve target to address the specific challenges it may face. According to the GFOA, governments may need to set policies to maintain more than the minimum recommended reserves. The GFOA has identified five factors that governments should consider when setting a reserve target. As indicated in Table 2, Richmond has not sufficiently reduced or eliminated risks related to three of the five factors, which could lead the city to need greater reserves than its current policy dictates. For example, the city could experience volatile revenues and expenditures during the next few years because of unusual inflation and other economic trends. Beginning in fiscal year 2022–23, Richmond's reserve policy now requires a range of reserves from 15 percent to 20 percent of general fund expenditures; however, this minimum may still be too low to meet the city's needs.

[1] We include in this calculation both the $162 million Richmond reported in general fund expenditures and an additional $16 million it transferred out of the general fund that year. The city's reserve policy requires that transfers out be included along with expenditures to calculate the reserve level.

Figure 2
Richmond Has Been Increasing Its General Fund Reserves



Source: Richmond's audited financial statements and staff reports to the city council.

Note: This figure does not include portions of the general fund balance that Richmond identified as nonspendable or otherwise restricted.

* The fiscal year 2021–22 reserve is based on unaudited estimates from the city.

Insufficient reserves could leave Richmond unable to respond effectively to financial emergencies or maintain city services during economic downturns. Although maintaining two months of reserves is an important milestone that could help the city weather a short-term crisis—such as emergency infrastructure replacement—the city's minimum target of 15 percent could quickly prove inadequate in the face of a severe recession or long-term economic downturn, especially given Richmond's other risk factors.

In fact, Richmond's independent auditor found that the city's reserves constituted a significant weakness as of June 2021. The city's auditor noted that the low general fund balance could eventually require Richmond to cut costs significantly in order to continue operations while also building up its reserves. Moreover, a city consultant has indicated that cost-cutting measures could include reducing the overall number of city employees and shuttering certain services, such as library branches. Though dedicating funds to maintain adequate reserves could require Richmond to make difficult budgeting decisions over the next several years, doing so may be necessary to ensure that it can maintain services during uncertain economic times ahead. After we shared our concerns regarding the city's reserve levels with Richmond, staff reported to the city council that the city

would perform an analysis on adequate reserve levels based on the GFOA's guidance. Doing so will be an important step in ensuring that Richmond seeks to maintain adequate fund balances to support its unique needs.

Table 2
Richmond Has Multiple Areas of Concern That May Require Increased Reserves

GFOA IDENTIFIED RISK FACTOR	HAS RICHMOND REDUCED OR ELIMINATED THE RISK?	CONDITIONS WITHIN RICHMOND
Predictability of revenues and expenditures	*NO*	Richmond has identified the potential for significant year-to-year variation in its revenue and expenditures. The city has also acknowledged that inflation is a significant uncertainty going forward.
Risk of one-time and emergency expenditures	*NO*	As we discuss later in the report, the housing authority represents an ongoing risk of significant one-time expenditures for Richmond.
Potential need for general fund support of other funds	*NO*	Several of Richmond's other funds have had negative balances, some in excess of $2 million, that staff proposed using the general fund to stabilize in October 2022. It remains to be seen whether the city can avoid future deficits in its other funds.
Potential impact on bond ratings	*YES*	Richmond's credit rating has been steadily improving. The city recently received a reaffirmed credit rating of AA- from Standard & Poor's in August 2022.
Planned other uses for unrestricted funds	*YES*	Richmond has previously allocated millions in its reserves for other purposes. In June 2021, for example, Richmond reported that more than $12 million of its $34.7 million reserve had already been allocated. In October 2022, after we highlighted this risk, staff proposed releasing the majority of its allocated funds such that only $1.4 million of the reserve would have planned uses.

Source: Richmond's audited financial statements, Richmond's financial projection and budget documents, staff reports to the city council, reports from credit-rating agencies, and interviews with city budget staff.

Richmond Forecasts a Significant Long-Term Deficit, Which Evolving Financial Trends May Worsen

Richmond's recent budget projections—produced by two different consultants and by city staff members using various models over multiple years—all predict that it will face future deficits because of inadequate general fund revenues and rising expenditures. For example, in 2021 a consultant anticipated annual budget deficits that would grow from $8 million in fiscal year 2022–23 to $26 million in fiscal year 2027–28, eventually declining and stabilizing at $18 million annually through fiscal year 2030–31. Richmond city staff members completed their projection in September 2022, showing less severe deficits of about $13.8 million in fiscal year 2025–26 before shrinking to $9.4 million by fiscal year 2027–28. Despite the differences between the consultant's projections, approach, and assumptions and those of the city staff, city staff members agree that Richmond is facing future deficits. City staff have identified several long-term obstacles to fiscal sustainability, including future costs for infrastructure maintenance, the need to fund growing retirement benefits costs, and the difficulty of addressing these challenges while building up adequate reserves. As Richmond's consultant warned in 2021, not addressing projected budgetary shortfalls could result in the city being unable to support key city services.

In recent years, Richmond has avoided deficits both through unexpected revenue and the implementation of a variety of short-term and long-term measures, as the text box describes. For example, in fiscal year 2020–21, the city anticipated $6 million in revenue from its property transfer tax; however, it received $20 million, largely due to tax revenue from several large property sales. This unexpected $14 million—which the city indicates is unlikely to reoccur—accounts for the entire $10.5 million increase in Richmond's general fund balance for that fiscal year. In addition, Richmond decreased its expenses by taking steps such as keeping certain positions vacant and freezing staff compensation levels.

Examples of Strategies and Circumstances That Allowed Richmond to Avoid Deficits in Recent Years

The city identified key measures it employed or circumstances it benefited from which allowed it to avoid deficits:

New Revenue. In 2018 and 2020, Richmond voters approved a new rate structure for taxes collected from property sales and increased a business tax.

Pandemic Recovery. In fiscal year 2020–21, the economic recovery from the pandemic contributed to the city collecting $5 million more in sales tax than it budgeted, $1 million more in property taxes, and almost $1 million more in utility taxes.

Salary Savings. Until recently, Richmond had not provided salary increases for non-public safety staff since 2015 or for many public safety positions since 2018.

Staff Vacancies. According to the finance director, about 6 percent of Richmond's approximately 690 city positions historically remain vacant.

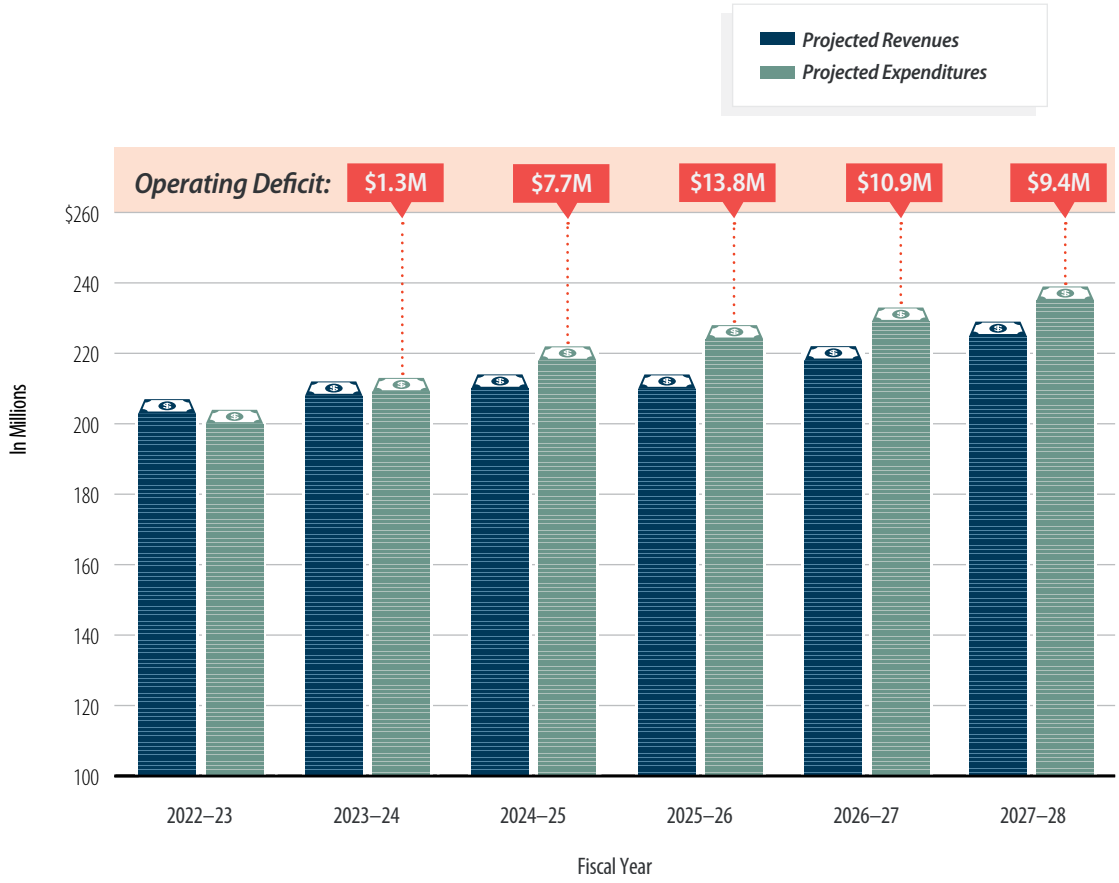
Source: Richmond's financial statements, Richmond's website, staff reports to the city council, and interviews with city staff.

Although some of the actions Richmond has taken—such as implementing new voter-approved taxes—will improve its long-term fiscal sustainability, others may not be sustainable in the future. For example, Richmond has relied on savings from freezing cost-of-living adjustments to some staff salaries since 2015; however, it recently increased staff compensation, which will decrease its ability to maintain balanced budgets. Thus, Richmond will likely need to seek additional revenue or decrease other expenses to prevent future deficits.

In 2021 a consultant provided an overview of past projections, an updated set of projections, and warnings about future fiscal issues to the city council. The consultant warned that, although the city might experience individual positive and negative economic events and might employ various strategies to report balanced budgets, it would still face a long-term structural deficit, largely because of increasing personnel costs. Ultimately, the consultant determined that Richmond would need to increase general fund revenues or decrease expenditures by $5 million to $21 million per year in order to both balance its budget and maintain at least minimum reserve levels.

The city's own financial forecast from September 2022 projects deficits averaging about $6.7 million annually through fiscal year 2027–28, the farthest the city has projected. Under this forecast, which Figure 3 shows, the city predicts that it will achieve a surplus in fiscal year 2022–23 but then operate at a deficit in each of the subsequent fiscal years, peaking at a shortfall of nearly $14 million in fiscal year 2025–26. The city identified rising costs to fund retirement programs and increased city salaries as contributing factors to its projected deficit.

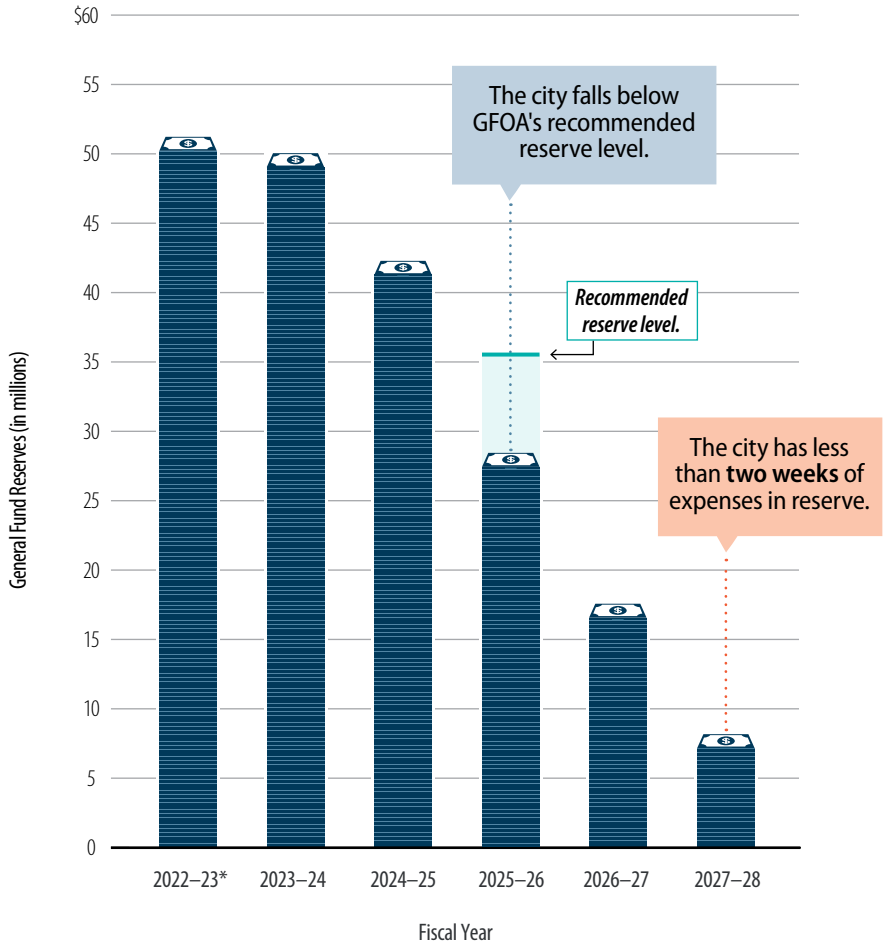
Figure 3
Richmond's Latest Projections Show Expenditures Exceeding Revenues



Source: Richmond's projection documents.

Richmond's current projections anticipate that, without significant cuts to city expenses or services or without new revenue, its general fund will run critically low on reserves in fiscal year 2027–28, reaching less than $9 million, or the equivalent of less than two weeks of expenditures, as indicated in Figure 4. Richmond's consultant has provided a variety of options for the city council to consider as long-term budget solutions to avoid deficits, including contracting out police services, contracting out or reducing library services, reducing social services, and substantially decreasing the city's workforce. Richmond's city council has not yet considered these actions because, according to the finance director, city staff is still analyzing its 2022 projection and is reviewing potential methods to create new revenue. Nevertheless, the city's projections suggest that it will soon need to reduce its expenditures by an average of more than $6 million annually unless its revenues increase by a similar amount. Otherwise, maintaining adequate services for its residents will become increasingly difficult.

Figure 4
Richmond's Forecasted Deficits Could Critically Deplete Its General Fund Reserves



Source: Documents provided by Richmond's finance department, staff reports to the city council, and the GFOA website.

* The starting fund balance in fiscal year 2022–23 is based on unaudited estimates the city published in October 2022.

Further, Richmond may encounter more severe shortfalls than it has forecast because of uncertain economic trends. First, Richmond's staff explained that the projection assumes that inflation—which was at 8 percent year-over-year as of August 2022—will largely return to normal rates after a single year. Though the city's forecast does account for certain expense increases due to inflation, such as higher health insurance costs, other expense projections may be too low if high inflation persists past 2023. The Congressional Budget Office and Federal Reserve Bank have predicted that it could take multiple years for inflation to return to long-term average rates, indicating that the city may spend more than it projects in future years because of higher inflation.

Second, the possibility of a recession threatens the city's long-term revenue potential. In 2021 Richmond's consultant noted that the city could face a mild recession beginning in fiscal year 2026–27, suggesting that including that possibility

in projections could help determine whether Richmond's reserves are sustainable. However, city staff explained that the 2022 projection does not include the chance of such a recession because events near the end of the decade were too far out for the city to predict. Instead, Richmond included what staff described as a conservative estimate of revenue growth in the first few years of the projection to account for immediate recession risks based on current economic events. However, if the city experiences cyclical recessions in six- or seven-year intervals, as the consultant predicted, *another recession at the end of the decade could significantly reduce revenues even as the city draws down its reserves*.

Applying more conservative assumptions to Richmond's projections indicates that the city may have to make steeper budget cuts sooner than it currently projects. For example, if current rates of inflation persist for some years, Richmond may experience higher than anticipated expenses in fiscal years 2024–25 and 2025–26. Additionally, if Richmond experiences a recession near the end of the period covered by its forecast, it might take in less revenue in fiscal year 2027–28 than predicted or run a series of deficits in the years following the end of its projections. Such deficits could cause Richmond to face more severe or more prolonged shortfalls than predicted and thus require the city to revisit the difficult budgeting decisions the consultant proposed, such as reductions in service or workforce.

In October 2022, we updated the annual assessment of fiscal risk we conduct related to California cities, which we use in part to identify cities that may require further review. During that update, we adjusted Richmond's overall fiscal risk rating to *moderate risk* based on financial information from fiscal year 2020–21. This change in rating and Richmond's movement from the 9th to the 10th city at greatest risk reflects improvement in certain risk indicators on our online dashboard. However, Richmond retains many high-risk characteristics, including its risk of significant projected deficits. Our ultimate designation of Richmond as *high risk* for the purposes of our high-risk local government agency audit program reflects the totality of the findings in this report and informs our report title, which notes Richmond's high-risk status.

The City's Debt Burden Remains High

Richmond's large debt burden may become a significant impediment to its ability to maintain balanced budgets. As of June 2021, Richmond had about $250 million in debt related to its governmental activities. However, in fiscal year 2020–21, only $1 million of Richmond's $162 million in operating expenditures in the city's general fund directly supported debt service. Richmond paid the remainder of its debt service—another $20 million in fiscal year 2020–21—with the city's other governmental funds, several of which are designated for this purpose.[2]

[2] Richmond operates a variety of additional funds for specific purposes, such as revenue collection, public safety, and support for certain grant programs. Moreover, it has three funds designated for paying debt service. Much of the money these funds use to pay debt service comes from a special property tax that we discuss later in this section.

These debt service payments represent a risk to the city's overall finances, including to the general fund. If Richmond's revenues from other sources prove insufficient, it may need to use general funds to support its debt service. Thus, the city's management of its overall debt load will be a key step to ensuring the sustainability of its operations in the future. The city's debt, and the potential strain it imposes on the city's revenues, leads us to determine that Richmond's debt burden is a high-risk area.

Much of Richmond's $250 million in outstanding governmental activities debt—56 percent as of June 2021—comes from its decision to create short-term savings using pension obligation bonds. Pension obligation bonds are a type of taxable bond that cities can use to fund their retirement programs and then pay back over decades. After it issued bonds totaling almost $115 million in 2005, Richmond sent $114 million in proceeds to CalPERS to support its retirement obligations. This issuance was part of a complex set of transactions, which resulted in Richmond paying only minimal debt service until two scheduled payment updates in subsequent years. The first of the payment updates occurred in 2013 and resulted in higher annual payments for $75 million of the bonds. A second update was set to further increase payments beginning in 2023 on another $128 million of the bonds.[3]

Richmond reports that it initially issued the debt in this manner because it needed short-term budgetary savings and lacked other options because of its poor credit rating at the time. The staff asserts that the bonds and related agreements created savings on combined debt and pension costs from 2005 through 2013, allowed for smaller savings from 2013 through 2020, and would result in increased costs after 2021. Under this debt arrangement, bond payments would have increased from a range of $9 million to $13 million annually—the amounts the city reported paying from 2013 through 2022—to a range of $15 million to $22 million annually. However, Richmond refinanced this debt in September 2022.

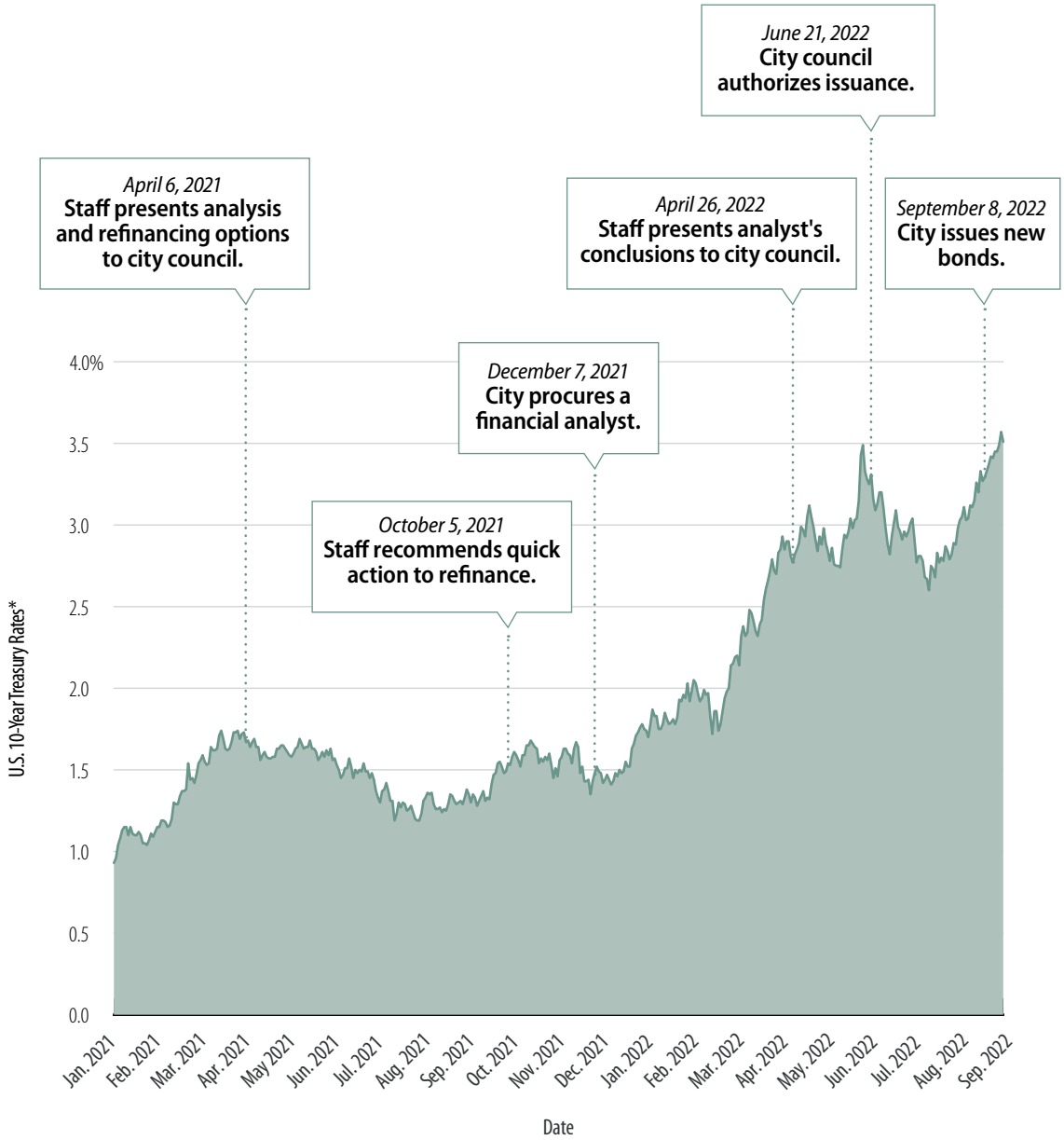
Richmond likely missed an opportunity to lower the debt service costs for its pension obligation bonds. From 2020 through much of 2021, interest rates on U.S. treasury bonds, which influence interest rates on other bonds, were at historic lows. Before September 2022, Richmond had been working toward refinancing its pension obligation bonds for more than a year in an attempt to take advantage of these low interest rates and avoid increased debt expenses. According to Richmond's finance director, managerial turnover and the city's lengthy process to find financial and legal consultants caused delay.

Although the city council instructed staff in June 2022 to issue new bonds, bond interest rates began rapidly increasing in March 2022. U.S. Treasury bond rates had almost doubled from 1.65 percent at the end of April 2021 to 3.15 percent as of August 2022. For perspective, such a rate increase on a $100 million 20-year bond issuance would result in about $900,000 in higher payments annually. The city's actual debt structure is more complex than a simple bond, and the city asserts that it achieved limited one-time savings in 2022 by reducing a fee payment by more than $1 million. However, the volatile interest rates we highlight provide an example of the risks cities take when issuing or

[3] The value of the bonds Richmond paid beginning in 2013 and would have begun paying in 2023 is higher than the initial $115 million in proceeds because it includes fees the city incurred both when it entered into the debt and when it subsequently negotiated its interest rates.

refinancing pension obligation bonds generally and the importance of considering market conditions. For example, in October 2021, staff noted that an interest rate increase of even a tenth of a percent could cost the city more than $1 million in current dollars. Figure 5 shows the timeline of some of the actions Richmond has taken toward refinancing since 2021 and how interest rates have increased over that time.

Figure 5
Richmond Deliberated About Refinancing Options for More Than a Year As Borrowing Costs Rose



Source: U.S. Treasury website, city council meeting minutes, and staff reports to the city council.

* U.S. treasury rates influence interest rates on other bonds.

Further, when Richmond refinanced its bonds, it extended its repayment period, which will add to the total amount of interest it will pay over the lifetime of the bonds. Though the city was scheduled to finish repaying the debt service on its original pension obligation bonds by 2034, it elected to pay debt service on the new bonds until 2044—an extension of 10 years. According to the city's financial consultant, this extension would further reduce costs to the general fund in the near term and shift more of the debt costs to the future when there would be higher tax revenues available for debt service. However, the consultant also warned that the city's total general fund costs related to its pensions and debt service for pension obligation bonds would consequently increase by $30 million over the life of the bonds.

Richmond's delay in refinancing its pension debt and its decision to increase the years required for debt service will impact its taxpayers for decades. Richmond pays the majority of the debt service on its pension obligation bonds through a surcharge on property taxes (pension tax). This arrangement limits the impact on the general fund of debt service for these bonds. However, it also highlights the city's duty to its taxpayers to secure the best possible investments and to efficiently use the taxes it levies.

Please refer to the section beginning on page 3 to find the recommendations we have made to address this area of risk to the city.

Addressing Its Poorly Funded Retirement Benefits and Below-Market Compensation Will Increase Richmond's Expenses

Significant Retirement Obligations Continue to Burden the City

Richmond's rising pension costs—the money it contributes annually to support its program to provide guaranteed retirement benefits—are an additional risk to its taxpayers and another potential barrier to maintaining balanced budgets. Richmond participates in CalPERS and pays annual contributions to its pension plans based in part on payroll size and investment growth and the size of its unfunded pension liabilities.[4] In fiscal year 2020–21, the city paid more than $35 million in pension costs, almost a quarter of its $162 million in total general fund expenditures for the year; however, some of the general fund costs—about $6 million to $10 million—are typically reimbursed through the pension tax.[5] As of 2022, CalPERS reported that Richmond's annual pension costs are increasing and projects they could reach $53 million by fiscal year 2028–29. Richmond's rising pension costs led to our determination that those pension costs are an area of high risk.

Richmond is incurring significant annual costs now because its historical contributions have been insufficient to fund all the promised pension benefits. The value of the city's investments have not yet recovered from significant losses in fiscal year 2008–09, nor has Richmond contributed significant additional funds to make up the shortfall. Thus, Richmond's pension funding level—the percent of assets it has relative to the cost of promised benefits—dropped to less than 71 percent in 2020, due in large part to minimal returns in several preceding years. By the end of fiscal year 2020–21, the funding level increased to more than 80 percent from strong investment returns for the CalPERS portfolio; however, this is still less than the 100 percent funding target the GFOA recommends. Further, this reported growth does not yet account for significant CalPERS investment losses in the most recent fiscal year. Although Richmond has been making annual payments assigned by CalPERS to address its shortfall, CalPERS projects that it will take decades for the payments to amount to a 100 percent funding level. These payments represent the majority of Richmond's projected pension costs. For example, in 2022 CalPERS projected that, in fiscal year 2028–29, about 66 percent of Richmond's payment would go to address the shortfall, while only 34 percent would fund ongoing pension costs. Contributing additional funds to CalPERS to further improve Richmond's funding status would require difficult budgeting decisions by the city. However, additional contributions represent an opportunity to reduce cumulative city expenditures by tens or hundreds of millions of dollars in the coming decades.

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4 Richmond's investments with CalPERS are separated into two plans—one specifically for safety employees and the second for other employees.

5 In addition to the city's two CalPERS plans, Richmond pays pension costs of less than $1.5 million for two smaller pension plans. We have focused our discussion on the two larger plans because they represent the significant majority of the city's annual pension costs.

In July 2022, Richmond's city council approved the use of an irrevocable trust fund for pension costs, which would give it an additional tool to address its pension shortfall.[6] According to CalPERS, such a fund can generate investment income to reduce pension impacts on city budgets and help to offset costs during financial crises. Staff members did not ask the council to adopt a specific funding schedule for the trust fund, but they reported that Richmond should be able to generate almost $1 million per year by seeking discounts from CalPERS for making the city's annual contribution at the beginning of the fiscal year, as it did in fiscal year 2021–22.

Although Richmond's pension trust fund may prove an effective decision, it also increases the risk the city will suffer long-term losses compared to other investment options. Staff reported to the city council that money placed in the pension trust fund might earn more than if the city kept the money in its existing investment accounts and that investing with a private fund manager would give the city greater control over the timing and risk levels of its investments. Staff also reported that the city could use the trust fund to pay immediate pension costs in an emergency. These represent important considerations. Nonetheless, while the private fund would allow the city to take on greater risk for potentially greater returns, such an action also increases the risk of losses. Further, the outside investment manager charges higher management fees than the fees CalPERS charges for similar trust funds.

The city could do more to evaluate possible options for managing its pension costs. Though staff members acknowledged to the city council that it would also be possible to send additional money directly to CalPERS rather than investing it in a trust fund, they did not provide the council an analysis of the relative fiscal benefits of such a strategy. Instead, they recommended using the outside trust fund because the city would be able to experience benefits sooner and have more control over its investments. The finance director asserted that the city's management held verbal discussions on the different options available and chose the private trust fund for flexibility and investment diversification reasons, but did not provide an analysis comparing the long-term fiscal benefits of the different options. Therefore, we are concerned that Richmond has not fully considered the value of using some or all of its expected $1 million in annual early-payment discounts to make additional payments to CalPERS and directly address its shortfall. Additional payments would only slightly reduce Richmond's annual contribution to CalPERS in individual years; however, they would have a cumulative effect over time, as amounts invested with the State double about every 12 years at CalPERS' expected investment growth rate.

Richmond May Have Missed Opportunities to Better Address Its Retiree Health Obligations

In addition to its pension costs, Richmond pays significant annual costs toward retiree health benefits. Richmond's OPEB programs fund medical insurance costs for its retired employees, with annual costs shared between the city and

6 The city already possessed a trust fund for certain retiree health funding, which we discuss in the next section. The city elected to use this trust fund for both its pension and other benefit costs by dividing it into multiple accounts going forward. We refer to these accounts as separate trust funds for the purposes of this report.

current employees. The city has contributed an average of more than $11.5 million per year since fiscal year 2016–17. Although the city has created trust funds to address its OPEB expenses, the funds' balances are not yet high enough to be effective. In 2008 the city established a trust fund that it could use to partially fund its future OPEB obligations in a similar manner to its approach to pension funding, a practice the GFOA recommends. As of June 2021, Richmond had $39 million in its two OPEB trust funds—significant growth over its $9 million balance in fiscal year 2016–17. However, the $39 million still represented only 27 percent of Richmond's promised future benefits.[7] This funding level is far short of the GFOA's recommended target of 100 percent funding. As a result, the funds' investment income has been historically inadequate to pay benefits without millions of dollars in additional annual contributions from the city.

In 2016 the city council adopted a policy to place into its OPEB trust funds half of its one-time revenues and half of its surpluses above those needed to meet its reserve goals. However, until recently, Richmond had not made a contribution under this policy since 2018. Richmond's finance staff explained that when the city increased its reserve target from 7 percent to 15 percent of its budgeted expenditures beginning in fiscal year 2018–19, the likelihood of dedicated contributions decreased. After we discussed the lack of contributions with city management, staff proposed and the city council approved a $6 million contribution to the OPEB trust funds in October 2022. The city also enacted a new policy in 2022 that removed the requirements for Richmond to make the types of contributions described above in the future.

We acknowledge that the city's surplus revenue may have been limited as it built reserves and responded to the pandemic. However, finance staff were only able to provide evidence of very limited analysis they had conducted to determine whether certain unexpected revenues qualified under the policy and should have been contributed to the OPEB trust fund. Notably, Richmond did not make dedicated contributions to its trust funds in fiscal year 2020–21, despite exceeding its reserve target by $6.5 million and reporting a surplus of $10.4 million, largely as a result of tax revenue from property sales. Thus, a contribution of up to $6.5 million may have been appropriate once the city determined how much of its surplus and revenue was eligible under its policies. Finance staff asserted that Richmond did not need to contribute any of this money to OPEB because the city set aside much of its surplus for future fiscal years. However, the city's policies did not exempt such set-aside funds from being considered for OPEB contributions. *Had Richmond completed a more thorough analysis to determine whether additional dedicated contributions were appropriate based on its OPEB funding policy and reserve policy in fiscal year 2020–21, it may have been able to more quickly increase the balance of its OPEB trust funds.* Increasing this balance would allow the city to reduce its long-term annual costs, potentially saving it millions of dollars in the coming decades.

[7] The majority of Richmond's OPEB funds are in the original trust fund it established in 2008. In 2017 the city established a second, smaller trust fund to invest OPEB funds for police officers.

Increasing the Competitiveness of City Salaries Will Incur Additional Costs

As part of Richmond's efforts to reduce expenses, it did not provide cost-of-living salary increases to city employees for up to the past seven years. Richmond provides different compensation packages for several groups of employees, such as those in executive positions, staff positions, and public safety positions. For its non-public safety employees, the city last offered a cost-of-living adjustment to salaries in July 2015, more than seven years ago. Meanwhile, before 2022, the city had last offered nonmanagerial public safety employees in the police and fire departments cost-of-living increases in 2018. As Table 3 shows, these decisions came in spite of prices having risen 24 percent since 2015. According to Richmond's budget administrator, these decisions to not provide salary increases represented the types of difficult steps the city has taken in order to promote fiscal stability.

Table 3
Richmond Delayed Providing Raises for Years as the Cost of Living Significantly Increased

EMPLOYEE CATEGORY	EMPLOYEE LEVEL	LAST COST-OF-LIVING ADJUSTMENT	RECENT OR NEXT COST-OF-LIVING ADJUSTMENT	INFLATION SINCE LAST COST-OF-LIVING ADJUSTMENT (THROUGH JUNE 2022)
Non-Safety	All	July 2015	Jan. 2023 (5%)	24%
Public Safety	Firefighters	July 2018	June 2022 (1%)	18%
	Fire Management	July 2018	None Scheduled	18%
	Police Officers	July 2018	June 2022 (1%)	18%
	Police Management	Jan. 2016	June 2022 (1%)	25%

Source: Richmond's bargaining agreements, Bureau of Labor Statistics website, and compensation information on Richmond's website.

Richmond's decision to reduce payroll costs likely contributed to its high vacancy rate for city positions and high turnover rates among employees. Although Richmond's overall vacancy rate varies from month to month and has been affected by such factors as hiring freezes during the pandemic, the director of finance stated that vacancy rates are about 6 percent annually—high enough to negatively affect department operations. Further, the city experienced several executive departures in recent years. As of April 2022, when the audit started, Richmond had filled some of those positions, including city manager, deputy city manager, library and community services director, and finance director, on an interim basis.[8] According to the city's data, as of April 2022, several departments were experiencing vacancy rates significantly above the 6 percent estimate. For example, the finance department reported a 24 percent vacancy rate, the police department a 20 percent vacancy rate, and the public works department a 15 percent vacancy rate.

[8] As of October 2022, one deputy city manager position continues to be vacant, and the library and community services director is filled on an interim basis.

Vacancy rates this high can affect the efficiency and effectiveness of city services and at times can result in increased costs. For example, the finance director acknowledged that Richmond's finance department has been adversely affected by high vacancies and turnover, limiting the staff's ability to take on projects and complete the department's duties. Similarly, the 20 percent vacancy rate in Richmond's police force has resulted in high overtime costs. Significant overtime can further result in issues with staff retention and may ultimately affect critical services.

Richmond is taking steps to increase employee compensation. In 2021 the city negotiated a cost-of-living adjustment for its non-safety employees. Richmond agreed to a 5 percent cost-of-living increase to take effect in January 2023, followed by 4 percent increases in each of the next two years. Richmond also provided a cost-of-living salary increase in 2022 to many of its safety employees, an increase that the city acknowledged it had delayed implementing since 2020. In addition to these adjustments, a consultant to the city issued a compensation study in 2021 that determined the city was typically paying 7 percent to 8 percent below the market rate for base pay for its positions. In response, the city built funding for addressing the consultants findings into its fiscal year 2022–23 budget.

These efforts to increase compensation represent a substantial policy shift for the city, as it must now identify alternative avenues for long-term savings or generate additional revenues. Although salary increases may assist Richmond in recruiting and retaining staff, the associated expenses will increase the burden on the annual budget. In June 2022, staff reported to the city council that the upcoming negotiated cost-of-living adjustments contributed to significant increases in fiscal year 2022–23 to salaries and benefits over the previous year. In total, the city expects an additional $7.4 million in fiscal year 2022–23 costs to implement compensation increases based on its consultant's report and cost-of-living adjustments. The finance director explained that Richmond is considering a variety of options to address these new costs, including reducing professional service expenditures and updating some positions' responsibilities to acknowledge that other positions are expected to remain vacant.

To alleviate the costs of increasing city employees' compensation, Richmond should also take the opportunity to reassess the size of its staff. Richmond budgeted savings of approximately $5.8 million from fiscal year 2021–22 vacancies, and it budgeted a vacancy savings of $8.3 million for fiscal year 2022–23, which staff asserted would compensate for that year's allocation for salary adjustment. Increasing recruitment would reduce the size of this savings. Although some recruitment is likely inevitable—for example, recruiting some additional police officers to reduce overtime—taking a measured approach to filling vacancies will allow the city the time to determine whether any departments, including police and fire, should or could operate with a smaller staff and thereby allow the city to eliminate vacant positions. For example, in fiscal year 2021–22, staff reported that eliminating 12 vacant positions in the police department saved $3 million from the police budget. The finance director has stated, that in some departments, high vacancy rates have limited operations and efficiency. Nevertheless, by assessing its staffing needs, the city may find other departments that need fewer additional staff than their vacancies would suggest.

Please refer to the section beginning on page 3 to find the recommendations we have made to address this area of risk to the city.

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The City Has Mismanaged the Richmond Housing Authority

A Decade of Mismanagement Will Result in the Housing Authority Transferring Its Public Housing Responsibilities to Other Entities

The city has ineffectively managed the finances of the housing authority for a decade and, as a result, HUD—the federal oversight agency for local housing authorities—has directed the housing authority to transfer its programs and resources to other entities. The housing authority is a separate legal entity from the city. The city manager acknowledges that the city manages the authority's finances but could provide no agreement between the city and the housing authority other than the city council's approval of the authority's budget. This included a general fund subsidy that provided $800,000 of its $4.8 million annual revenue in fiscal year 2021–22. Despite this support and assistance, the housing authority has failed to comply with basic financial requirements and best practices. This has increased the risk that neither the city, the housing authority, nor the public may be aware of the housing authority's actual financial condition.

Most importantly, the housing authority has not completed since fiscal year 2016–17 annual financial audits required by state and federal law. In July 2022, housing authority staff requested that the authority board and the city approve a contract amendment with the authority's financial services contractor to support the housing authority's auditors in completing their work. According to the housing authority's executive director, Richmond has not dedicated sufficient financial staff who are trained in federal requirements to the housing authority. City staff acknowledged in November 2018 that the city had not completed the necessary tasks to know the authority's financial position, such as being able to provide bank reconciliations. As of October 2022, the audits remain incomplete.

The lack of audited financial statements for the housing authority has in turn affected Richmond's financial reporting. From fiscal year 2016–17 to the most recent audited financial statements in fiscal year 2020–21, the city's auditors noted that they could not obtain sufficient appropriate evidence to provide an audit opinion on the financial statements for Richmond's businesslike activities, which include the housing authority. Because the housing authority has not completed its annual financial audits since fiscal year 2016–17, neither it, the city, nor those that the authority or the city serve can be confident in the authority's finances and its potential effects on the city.

In fiscal year 2020–21, Richmond also decided to not seek repayment for the costs of services provided to the housing authority because the expenses did not meet federal requirements. In 2021, a HUD consultant reviewed the city's 2019 audited financial statements and found that Richmond claimed that the housing authority owed it more than $15 million for services rendered, including nearly $5 million in indirect cost allocations. According to the HUD consultant, federal law disallowed nearly all—$14.7 million—of

those claimed expenditures. In 2022 the city decided to withdraw its claim for these expenses and was required to write off its claim to these funds before completing its fiscal year 2020–21 financial statements.

As a result of these and other instances of financial mismanagement and in response to HUD concerns, the housing authority is planning to transfer its housing programs and resources to other agencies and partners. As Figure 6 indicates, HUD identified significant deficiencies concerning the housing authority's financial practices, oversight, documentation, and accountability going back more than a decade. For example, in its 2009 audit, HUD found that the housing authority had issued payments for services related to the management of housing units without determining whether the invoiced amounts were appropriate. In a subsequent audit in 2016, HUD found that the housing authority had misled HUD on the status of its financial resources, submitted falsified documentation, and allowed the city to use the housing authority's HUD funds. It also found that the city had charged the housing authority for rent and services at prices that seemed excessive. HUD found that these actions resulted in more than $2 million in misspent HUD funds and nearly another $1 million in costs the housing authority could not support. The housing authority had also incurred other questionable transactions that unnecessarily limited its resources and the effectiveness of its public housing program.

HUD Performance Indicators

Physical Condition Indicator—Reviews whether the housing is decent, safe, sanitary, and in good repair.

Management Operations Indicator—Measures occupancy, tenant accounts receivable, and accounts payable.

Financial Condition Indicator—Determines whether sufficient financial resources exist to support the provision of housing.

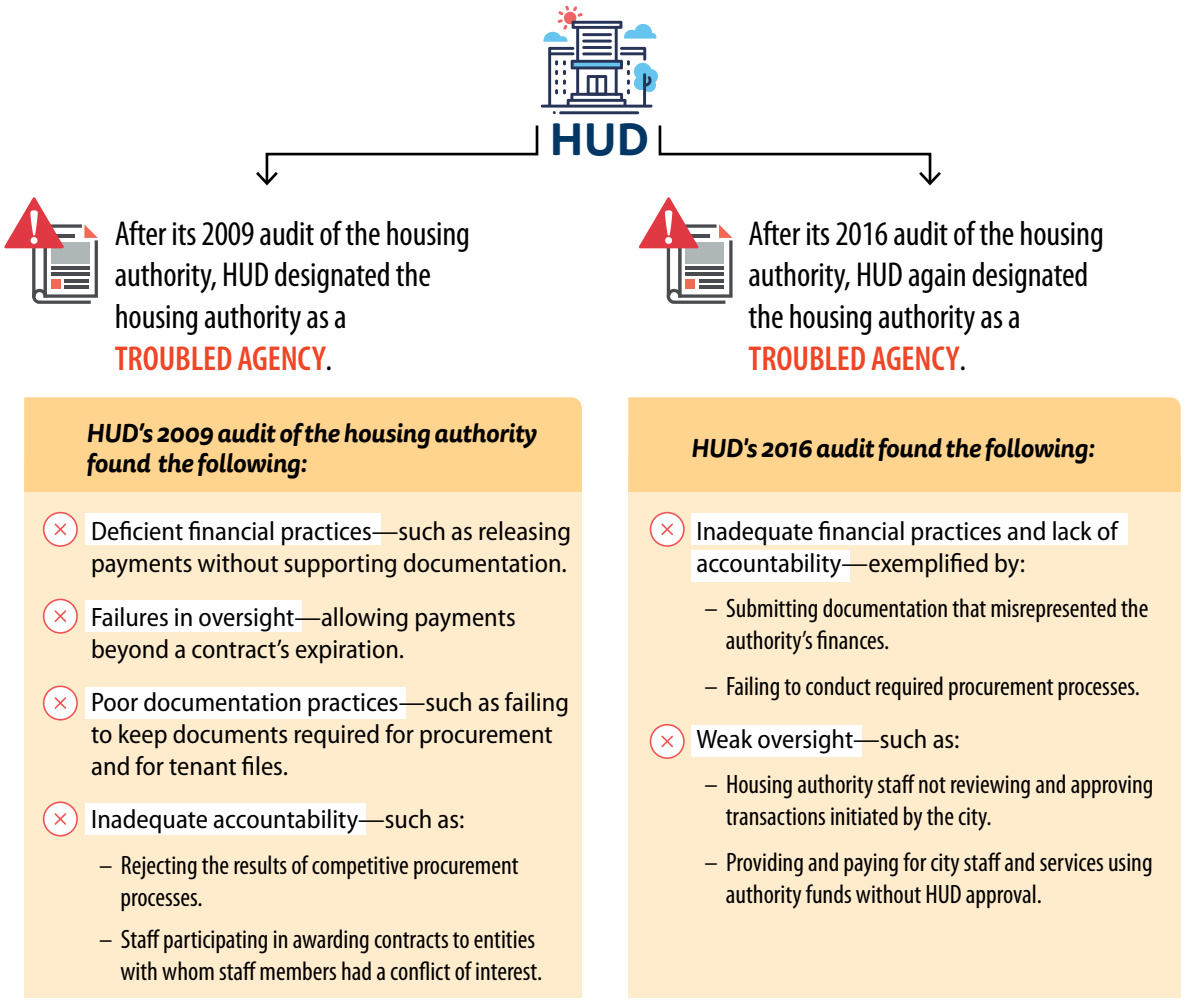
Capital Fund Program Indicator—Determines whether funds are obligated and units occupied within program grant deadlines.

Source: Federal law.

Further, in its annual evaluations of public housing performance, HUD has regularly found the housing authority to be deficient. In these reviews HUD assesses and scores the performance of public housing agencies based on the indicators noted in the text box. For the nine years from 2011 through 2019, HUD designated the housing authority as *below* HUD standards in seven of those years. From 2017 through 2019, HUD found the authority to be *well below* standards.

As a result of the consistently poor reviews, in 2019 HUD created and the housing authority signed a recovery agreement with the intent, according to HUD, to bring about the transfer of the housing authority's direct public housing responsibilities to other agencies and partners. Richmond acknowledged this agreement by the signature of its mayor and agreed to work in good faith to assist the housing authority and HUD in accomplishing the tasks in the agreement, many of which are described in the next section. This process, when complete, will result in the housing authority no longer directly providing housing because private entities will rehabilitate and manage its real property under long-term leases. The housing authority's role will be reduced to overseeing the lease agreements. The housing authority's partners will ultimately maintain the existing public housing in the future, but the housing authority's delays in completing the recovery agreement—and the associated delays in maintenance and rehabilitation of affected housing units—are negatively affecting Richmond residents who currently rely on that public housing.

Figure 6
HUD Has Repeatedly Identified Mismanagement of the Housing Authority


HUD
After its 2009 audit of the housing authority, HUD designated the housing authority as a TROUBLED AGENCY.
After its 2016 audit of the housing authority, HUD again designated the housing authority as a TROUBLED AGENCY.
HUD's 2009 audit of the housing authority found the following:
Deficient financial practices—such as releasing payments without supporting documentation.
Failures in oversight—allowing payments beyond a contract's expiration.
Poor documentation practices—such as failing to keep documents required for procurement and for tenant files.
Inadequate accountability—such as:
– Rejecting the results of competitive procurement processes.
– Staff participating in awarding contracts to entities with whom staff members had a conflict of interest.
HUD's 2016 audit found the following:
Inadequate financial practices and lack of accountability—exemplified by:
– Submitting documentation that misrepresented the authority's finances.
– Failing to conduct required procurement processes.
Weak oversight—such as:
– Housing authority staff not reviewing and approving transactions initiated by the city.
– Providing and paying for city staff and services using authority funds without HUD approval.

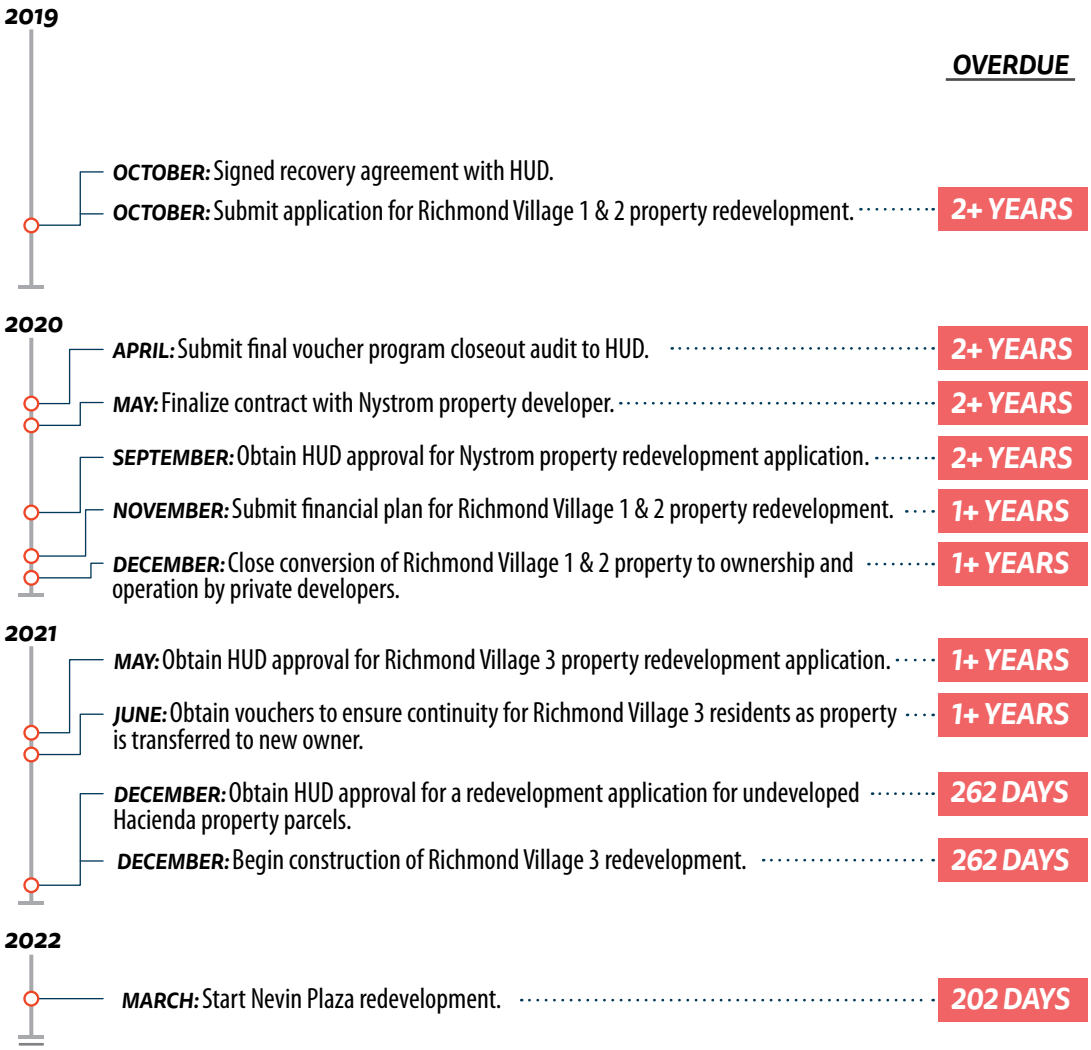
Source: HUD audit reports.

The Housing Authority Missed Mandatory Deadlines to Complete the Recovery Agreement

HUD may seek remedies because the housing authority is not complying with the recovery agreement. The recovery agreement requires the housing authority to meet target dates for 26 individual tasks, such as submitting a financing plan and issuing a request for redevelopment proposals. Due dates range from October 2019 to November 2022. The authority has made some progress in satisfying the terms of the recovery agreement. For example, the authority stated that it transferred to another organization a property that had been vacant since 2015 because it was uninhabitable. However, as of September 2022, the housing authority had missed 11 other deadlines, many by more than a year, as Figure 7 shows. In May 2022, HUD stated in a letter to the housing authority that it will not provide extensions to these

deadlines and will instead seek remedies against the housing authority, including suspension or debarment.[9] In July 2022, the housing authority reported to its board that it had not been able to meet required deadlines because of staffing shortages and unspecified "unforeseen cirumstances." The housing authority's executive director also indicated that, although the deadlines were originally reasonable, the pandemic has made the deadlines unreasonable, as each step required additional time to complete.

Figure 7
The Housing Authority Has Failed to Comply With HUD's Recovery Agreement Deadlines as of September 2022


2019
OVERDUE
OCTOBER: Signed recovery agreement with HUD.
OCTOBER: Submit application for Richmond Village 1 & 2 property redevelopment.
2+ YEARS
2020
APRIL: Submit final voucher program closeout audit to HUD.
2+ YEARS
MAY: Finalize contract with Nystrom property developer.
2+ YEARS
SEPTEMBER: Obtain HUD approval for Nystrom property redevelopment application.
2+ YEARS
NOVEMBER: Submit financial plan for Richmond Village 1 & 2 property redevelopment.
1+ YEARS
DECEMBER: Close conversion of Richmond Village 1 & 2 property to ownership and operation by private developers.
1+ YEARS
2021
MAY: Obtain HUD approval for Richmond Village 3 property redevelopment application.
1+ YEARS
JUNE: Obtain vouchers to ensure continuity for Richmond Village 3 residents as property is transferred to new owner.
1+ YEARS
DECEMBER: Obtain HUD approval for a redevelopment application for undeveloped Hacienda property parcels.
262 DAYS
DECEMBER: Begin construction of Richmond Village 3 redevelopment.
262 DAYS
2022
MARCH: Start Nevin Plaza redevelopment.
202 DAYS

Source: Housing authority documentation.
Note: Overdue total as of September 19, 2022.

[9] A suspension is imposed for a temporary period, pending the completion of an investigation or legal proceeding, and it results in an immediate exclusion from participation in further government transactions. A debarment sanction means that an organization and its affiliates are excluded from conducting business with any federal agency. Debarments are imposed for criminal and/or serious HUD program violations. A suspension may lead to debarment.

Avoiding delays in the recovery agreement is critical because it helps ensure that residents have safe housing. Under federal and state law, the housing authority is responsible for ensuring that the housing units it provides are habitable and safe. However, the housing authority has not always been able to meet HUD's physical conditions indicator; in 2013, 2014, and 2018, the housing authority scored low enough on this indicator for HUD to require corrective action. Residents of one housing authority building sued the city and housing authority in 2015, listing mold, vermin, faulty elevators, and lax security as some of the conditions they had to endure. The city and the housing authority settled this lawsuit in 2019 for more than $650,000. The housing authority stated that it directly manages about 240 housing units in two complexes as of August 2022 and indicated that, under the recovery agreement, it will sell or transfer all the housing units to other entities. For example, the housing authority entered into a long-term lease with a developer for the Hacienda development, which will rehabilitate the building and manage it as affordable housing for seniors. Further delays in the housing authority's implementation of the agreement could result in residents experiencing more problems in their housing and more lawsuits.

The Housing Authority May Owe the Internal Revenue Service $1 Million or More in Taxes and Penalties

The Internal Revenue Service (IRS) claims that the housing authority owes significant taxes and penalties from 2018 and 2019. Federal law requires the housing authority to submit tax information on property owners who receive federal funds through the housing authority—in this case through a housing voucher program—to ensure that those property owners pay the taxes they owe and, in some instances, to withhold taxes and submit them on the property owners' behalf. *The housing authority reported to its board in June 2022 that it had failed to report tax information in 2018 and 2019, and that failure to comply could result in $9 million in withholding taxes and penalties.*

The housing authority took no significant action to address this potential liability until the start of this audit. However, it has been able to submit sufficient records so that the IRS agreed to reduce the remaining taxes and penalties to $1 million. According to the housing authority's executive director, the city, which provides financial services for the housing authority, had not provided sufficient support or resources to allow it to meet IRS requirements. The city manager indicated that the prior finance director and housing authority executive director were not engaged in the level of detail as the new finance director and executive director. Although the city is not directly liable for these debts, because it provides significant funding to the housing authority, the existence of the outstanding taxes and penalties results in increased risk to Richmond.

Please refer to the section beginning on page 3 to find the recommendations we have made to address this area of risk to the city.

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The City Has Not Consistently Followed Its Contracting Policies or Updated Its Fees as Required

Richmond Could Do More to Demonstrate It Is Following Requirements to Ensure the Best Value for Its Contracts

Lack of documentation sometimes makes it difficult for Richmond to demonstrate that it complies with its own contracting policies. The city's municipal code and its purchasing policy outline requirements that promote fairness and transparency in how it selects vendors. Specifically, for contracts between $5,000 and $50,000, city staff must contact vendors to obtain three written quotes before awarding the contract. For contracts valued at $50,000 or more, the city must follow a competitive bidding process. The municipal code allows for limited exceptions to its requirements for multiple quotes or bids, such as during an emergency or when the city determines it is economical for the city to use the pricing and terms established by another public agency. Such requirements are key measures that help ensure that the city is fairly selecting vendors that provide the best value. However, when we reviewed 10 contracts the city entered into from 2019 through 2021, we identified at least two instances in which the city could not demonstrate that it followed its own procurement policies or it had made errors or omissions that could have affected its management of contracts.

In one example related to a $24,500 contract approved by the city council, Richmond did not justify its use of an alternative contracting process that allows it to purchase supplies, equipment, or services by using the pricing and terms of a contract negotiated by another public agency that has already procured those same goods or services. The municipal code allows Richmond to use this method so long as the finance department determines it would be in the city's best interest. However, staff did not perform such an analysis and did not explain that Richmond was using this method when reporting the contract to the city council. For another contract originally bid at $63,800, city staff proposed and the city council approved a higher value of $71,200 for the contract without a documented explanation. Inconsistent documentation limits the city's ability to demonstrate that it is properly procuring goods and services and complying with its own policies.

According to finance staff, staff from other departments typically enter into contracts that the finance staff then approves. The finance department has not required other staff to follow specific formats when submitting related documentation. When we reviewed with the finance department the various documentation issues we identified, staff acknowledged the need for stronger and more consistent contract documentation practices going forward. The finance director also noted that the finance department had enforced more rigid documentation requirements in the past but that turnover in other departments has increased the workload for finance staff because of the need to provide more training. She further explained that the city was implementing a new training program to familiarize other departments' staff with procurement requirements.

As we discussed earlier, competitive bidding allows the city to demonstrate that it is obtaining goods and services at the appropriate value and selecting vendors without inappropriate influence. When Richmond does not adequately document its adherence to bidding requirements or the use of allowable exceptions to its procurement process, it risks overspending for goods and services.

City Staff Have Not Updated Fee Schedules as Required

Richmond has not consistently updated its service fees, and as a result, it risks incurring general fund costs for each service those fees should cover. The city's municipal code generally requires the city manager to update the city's fee schedule annually to ensure that fee-supported services, such as engineering site plan reviews or code compliance inspections, have fees that are sufficient to cover the cost of those services.[10] While performing the annual update, the city must consider components such as direct costs and overhead, as the text box describes. The municipal code also requires that the city's finance director propose quarterly to the city council any adjustments to its taxes and fees based on the Employment Cost Index (ECI). The ECI is a federal economic indicator that measures changes in hourly labor costs to employers. Despite setting these requirements, the city has not conducted either updates or adjustments at the required frequency.

Cost Components for Fee Updates

Applicable Direct Costs, such as wages, overtime, benefits, services, and supplies.

Applicable Indirect Costs, such as building and equipment maintenance and operation, communications and computer expenses.

Overhead, including but not limited to the distributed costs of the department head and support staff, and of the city council, city manager, finance department, and other staff and support services provided to the entire city.

Other Costs, including debt service costs and fixed asset depreciation.

Source: Richmond municipal code.

From 2018 through 2022, Richmond did not review and update the full range of its existing fees. Richmond performed three partial updates during this period—in 2018, 2020, and 2022. In 2018 Richmond analyzed the costs associated with the services its Planning Division provided and updated the associated fees. However, it updated only a selection of fees from two others of its eight fee-levying departments and divisions: its Water Resource Recovery Division and Library and Community Services Department. For example, the city updated only six of the 50 fees used by its Water Resource Recovery Division. It made no fee updates for the remaining city departments in 2018 and no fee updates at all in 2019 or 2021. In 2020 Richmond updated certain fees that developers could pay in lieu of constructing affordable housing units within residential development projects, but its updates did not include all fees for the Building Division or any fees for other departments or divisions in the city. Richmond's 2022 effort was improved but still not complete. At that time, it conducted full fee updates for the police and fire departments and for Code Enforcement, and it updated a selection of

[10] The fee schedule requires an annual update for a majority of the fees it lists. However, a small subset of fees, such as those levied for investigating work done without permits, require updates only as needed.

fees for departments and divisions, including Community Development and the Library, but it did not conduct fee updates for other departments. Figure 8 provides a summary of Richmond's fee updates for the eight key departments from 2018 through 2022.

Figure 8
Richmond Has Not Regularly Updated Its Fees and May Not Be Recovering Costs for Related Services

2018
2019
2020
2021
2022
Police Department
Fire Department
Library and Community Services
Public Works Engineering Department
Public Works Water Resource Recovery
Community Development Planning Department
Community Development Building Department
Community Development Code Enforcement
The city updated the department's fees to reflect the cost of providing services.
The city updated some but not all of the department's fees to reflect its costs.
The city did not update any of the department's fees to reflect the cost of providing services.

Source: Richmond municipal code and analysis of Richmond city council agenda documents from 2018 through 2022.

Note: The analysis above includes updates to existing fees and does not include the addition of various new fees the city implemented between 2018 and 2022.

Even the fee updates Richmond has completed may be inadequate. We reviewed three of the largest fees Richmond assessed—accounting for 15 percent of Richmond's assessed fees in fiscal year 2020–21—to determine whether the city was reasonably recovering its costs. The city was unable to provide documentation detailing how it calculated costs related to an engineering permit fee for digging and therefore cannot demonstrate that it is appropriately recovering its costs. Richmond was able to provide documentation partially supporting the reasonableness of the other two fees we reviewed. In 2020 the city updated its building fees related to developing affordable housing based on a fee assessment completed in 2019, and in 2018 it updated its fees for reviews of California Environmental Quality Act filings. However, because it has

not updated these fees in several years, it is unclear whether the updated assessments continue to cover the city's costs. In fiscal year 2020–21, the city assessed fees of $2.1 million in developer fees and $1.6 million for environmental impact report reviews.

Richmond has also not adjusted its rates and fees for inflation as frequently as is set forth in its municipal code. We found that, from 2018 through 2022, Richmond adjusted its fee schedule to account for inflation on a roughly annual basis while the municipal code requires quarterly adjustments. The city states that it has adjusted its fees annually rather than quarterly for more than a decade because of the labor-intensive nature of fee updates. Although that did not meet the requirements of the municipal code, we estimate that the city's practice of adjusting its fees annually rather than quarterly resulted in a limited financial impact of $208,000 in 2021, the equivalent of only 0.7 percent of the total fees it collected.

The city indicated that updating its fees on a set schedule has not been feasible because of staffing limitations and the significant amount of labor required to calculate fee increases. The city's assessment may be reasonable given the staffing issues we identified earlier. The city must balance the time and labor of conducting more frequent updates against any potential lost revenue to determine a reasonable frequency for conducting citywide fee updates, and it should revise its municipal code to reflect its decision on the required frequency of those updates.

Please refer to the section beginning on page 3 to find the recommendations we have made to address this area of risk to the city.

We conducted this audit in accordance with generally accepted government auditing standards and under the authority vested in the California State Auditor by Government Code section 8543 et seq. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

MICHAEL S. TILDEN, CPA
Acting California State Auditor

November 10, 2022

APPENDIX A

The State Auditor's Local High-Risk Program

Government Code section 8546.10 authorizes the California State Auditor (State Auditor) to establish a local high-risk program to identify local government agencies that are at high risk for potential waste, fraud, abuse, or mismanagement or that have major challenges associated with their economy, efficiency, or effectiveness. Regulations that define high risk and describe the workings of the local high-risk program became effective on July 1, 2015. Both statute and regulations require that the State Auditor seek approval from the Joint Legislative Audit Committee (Audit Committee) to conduct audits of local entities.

To identify local entities that may be at high risk, we analyze audited financial statements and unaudited pension-related information for more than 470 California cities. This detailed review includes using financial data to calculate indicators that may be indicative of a city's fiscal stress. These indicators enable us to assess each city's ability to pay its bills in both the short and long term. Specifically, the indicators measure each city's financial reserves, debt burden, cash position or liquidity, revenue trends, and ability to pay for employee retirement benefits.

In October 2019, we determined that Richmond potentially met the criteria for being at high risk. We conducted an assessment in February 2021 to determine the city's awareness of and responses to these issues as well as to identify any other ongoing issues that could affect our determination of whether the city is at high risk. After conducting our initial assessment, we concluded that Richmond's circumstances warranted an audit. We sought and, in June 2021, obtained approval from the Audit Committee to conduct an audit of Richmond.

If a local agency is designated as high risk as a result of an audit, it must submit a corrective action plan. If it has not provided its corrective action plan in time for inclusion in the audit report, it must provide the plan no later than 60 days after the report's publication. It must then provide written updates every six months after the audit report is issued regarding its progress in implementing its corrective action plan. This corrective action plan must outline the specific actions the local agency will perform to address the conditions causing us to designate it as high risk and the proposed timing for undertaking those actions. We will remove the high-risk designation when we conclude that the agency has taken satisfactory corrective action and the deficiencies in the audit have been satisfactorily addressed.

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APPENDIX B

Scope and Methodology

In June 2021, the Audit Committee approved a proposal by the State Auditor to perform an audit of Richmond under the local high-risk audit program. We conducted an initial assessment of Richmond in February 2021 in which we reviewed the city's finances to determine whether it demonstrated characteristics of high risk pertaining to the following six risk factors specified in state regulations:

- The local government agency's reported financial condition has the potential to impair its ability to efficiently deliver services or to meet its financial or legal obligations.
- The local government agency's ability to maintain or restore its financial stability is impaired.
- The local government agency's financial reporting does not follow generally accepted government accounting principles.
- Prior audits reported findings related to financial or performance issues, and the local government agency has not taken adequate corrective action.
- The local government agency uses an ineffective system to monitor and track state and local funds it receives and spends.
- An aspect of the local government agency's operation or management is ineffective or inefficient; presents the risk for waste, fraud, or abuse; or does not provide the intended level of public service.

Based on our initial assessment, we identified concerns about Richmond's financial condition and outlook and its debt. The following table lists the objectives that the Audit Committee approved and the methods we used to address them.

Audit Objectives and the Methods Used to Address Them

	AUDIT OBJECTIVE	METHOD
1	Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Identified and reviewed relevant federal and state laws, rules, regulations, municipal code, and other background materials applicable to the city.
2	Evaluate Richmond's current financial condition and ability to meet its short-term and long-term financial obligations while continuing to provide services to its residents.	• Developed and analyzed trends of revenues, expenditures, and other relevant financial risk indicators from fiscal years 2016–17 through 2020–21. • Reviewed the city's methodology for creating its financial projections and assessed whether those projections are reasonable. • Assessed the reliability of selected data elements in the city's financial systems. • Reviewed the city's financial statements and accounting records to determine the position of its enterprise funds and the degree to which it has relied on general fund subsidies in the past five fiscal years.
3	Identify the causes of Richmond's financial challenges and determine whether the city has developed an adequate plan for addressing those challenges. This will include assessing the city's efforts to improve its financial condition by increasing revenue and reducing expenditures.	• Interviewed city staff and reviewed documentation, such as presentations to the city council, to identify underlying revenue and expenditure issues the city believes are contributing to its financial challenges. • Reviewed Richmond's "Plan 2030," financial forecasts and presentations, and related documentation. • Assessed the extent to which staff compensation contributed to Richmond's financial challenges by doing the following: reviewed Richmond's salary survey, budgets, and federal inflation reports to determine when the city last provided cost-of-living increases to its staff and to estimate the impact of inflation since that time, compared recent staff salaries in key positions to those in neighboring cities, and reviewed staffing levels for departments with significant vacancies or overtime. • Assessed risks related to the city's reliance on pension obligation bonds and current refinancing plan based on GFOA guidance and available reports on pension costs. We also reviewed the city's planning and costs related to its OPEB liabilities.
4	Determine whether Richmond's budgeting processes align with best practices. In addition, evaluate the city's procedures and underlying assumptions for projecting future revenue and expenditures, and determine whether the projections result in balanced budgets and accurate financial forecasts.	• Evaluated the policies, processes, and practices the city used to develop its budgets and compared them with applicable criteria and GFOA best practices. We determined that the city complied with its policies, processes, and practices when developing its budget. Further, we determined that Richmond's budgeting practices comply with GFOA best practices. • Assessed the reasonability of assumptions used by the city in its revenue and expenditure projections. We reviewed budget and financial records to determine whether the projections resulted in balanced budgets and accurate financial forecasts from fiscal years 2016–17 through 2020–21.
5	Assess Richmond's process for setting, increasing, or decreasing fees or rates to ensure that it complies with applicable laws, rules, regulations, and best practices. For a selection of these fees and rates, determine whether they cover the city's costs of providing services.	• Reviewed state law, the city's municipal code, and guidance from GFOA and the California and National Leagues of Cities to identify requirements and best practices for setting municipal fees and rates. • Interviewed staff and reviewed documentation to determine Richmond's process for setting fees and rates. We determined whether that process complied with state law, the municipal code, and best practices. • Assessed whether city's fees covered its costs for providing services by reviewing supporting documentation for the rates for three fees.

	AUDIT OBJECTIVE	METHOD
6	Evaluate Richmond's efforts to address the deficiencies its external auditors identified in their reports for fiscal year 2018–19 and earlier years and those the Inspector General identified in its 2016 report related to the Richmond Housing Authority.	• Conducted interviews and reviewed the city's and housing authority's documentation to determine the progress of the city and housing authority to address associated audit recommendations. • Conducted interviews and reviewed documentation to assess the housing authority's efforts to comply with the recovery agreement timeline. Further, to the extent possible, we assessed the risk to the city associated with missing associated deadlines.
7	Review and assess any other issues that are significant to the audit.	• To assess the city council's compliance with open-meeting laws related to closed sessions, we reviewed five closed city council meetings held from 2018 through 2021. We had no reportable findings. • To assess potential conflict-of-interest violations, we reviewed statements of economic interest submitted by the city council, mayor, and certain other leadership positions. We had no reportable findings. • Reviewed a selection of 10 contracts from the city's purchasing database and paper records from 2019 through 2021 to determine whether the city followed its competitive bidding and contract approval requirements, the city received the services procured, and the city made payments in accordance with the contract terms.

Source: Audit workpapers.

Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily obligated to follow, requires us to assess the sufficiency and appropriateness of computer-processed information we use to support our findings, conclusions, or recommendations. In performing this audit, we relied on electronic reports that we obtained from the city's financial system. We completed data validation, logic, and completeness testing. We found the city's financial accounting system to be sufficiently reliable for the purpose of reviewing its financial condition.

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CITY MANAGER'S OFFICE

October 21, 2022

Via Email – NickP@auditor.ca.gov

Michael S. Tilden, CPA*
Acting California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Re: State Auditor's Recommendations
2021-806 – Confidential Draft Audit Report

Dear Mr. Tilden:

The City of Richmond ("City") is pleased to have the opportunity to comment on the recommendations ("Recommendations") from the State Auditor's Report ("Audit Report") dated November 10, 2022.

The City has observed the representatives of the State Auditor's Office ("Office") over the last several months as we provided information and worked together to make the Audit Report accurate and helpful. We believe the Office has acted with professionalism, sound judgment, and fairness to provide an Audit Report which will be helpful to the City. Finally, we appreciate that this response will be published along with the Audit Report itself.

The comments herein are those of the City Staff. Given the limited time posed for review, we were able to share a draft of the Audit Report at a City Council closed session held pursuant to Govt. Code § 54956.75 on October 18, 2022, to ensure that Councilmembers are aware of the recommendations, but not of the responses which were subsequently drafted and contained herein. Council sets policy; accordingly, all matters of policy will go to the Council at a public meeting for actual determination.

City staff responses to each recmmendation included in the Audit Report are included below. We understand that descriptions of the findings and conclusions that led to these recommendations can be found in the sections of Audit Report.

1. To help ensure that Richmond maintains appropriate reserves for times of fiscal uncertainty, city staff should, by June 2023, review Richmond's reserve policy to determine whether a higher reserve target is appropriate. As part of the review, staff should consider all the factors the Government Finance Officers' Association (GFOA) recommends for setting a reserve target. Once that review is complete, city staff should present proposals to the city council for modifying the city's policy.

   The City Staff agrees with the recommendation and will continue to review its Reserve Policy. In recent years, the City has continuously improved its reserve level, but it was still below the City reserve policy target of 15 percent as of June 30, 2021. On September 20, 2022, the City Council adopted a new Cash Reserve

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* California State Auditor's comment appears on page 43.

Policy with a minimum target reserve level increased to a range up to 20 percent, meeting GFOA standards. The City is estimated to end Fiscal Year (FY) 2021-22 with a reserve level well above its policy range at 22.95 percent of the General Fund expenditures budget for FY 2022-23. The City staff will perform an analysis per the GFOA best practices on the five risk factors and present such updated analysis to the City Council.

2. To decrease the risk that Richmond will deplete its reserves, city staff should, by June 2023, present to the city council a list of proposed budget actions that would help ensure balanced budgets and eliminate projected deficits.

   Under the City Council approved Guiding Fiscal Policies, the City is required to develop an annual budget guided by a long-term financial plan. For the past several years, with the exception of recent pandemic years, the City has adopted a balanced annual budget and also has ended each fiscal year with a significant surplus. The City staff will continue to work with the City Council on developing a long-term plan and then develop a structurally balanced budget for FY 2023-24.

3. Richmond should include multiple scenarios in its financial projections, including scenarios with potential additional risks, such as economic downturns or recessions, and how the city would continue to fund its operations under those circumstances.

   The City staff agree that in present circumstances, economic downturns and recessions need to be factored into budgets. The City continues to use its Five-Year Forecast as a dynamic document to assist and inform in strategic decision-making processes, including labor negotiations and budget development. The City will work on refining its Five-Year Forecast and incorporate all the factors, global and local, impacting the City's fiscal health, including but not limited to recession, inflation, housing market, etc. The City staff plans on bringing back a refined forecast with multiple scenarios by spring 2023 prior to the FY 2023-24 budget development.

4. To ensure that Richmond is able to fund its retirement-related costs, city staff should, by June 2023, propose to the city council a specific policy regarding funding of its pension trust fund for this purpose. Staff should report to the city council on estimated long-term savings from increasing its direct payments to Cal PERS compared to investing the same amounts in its pension trust fund. Staff members should use this information to inform their recommendations related to funding targets for the pension trust fund and should consider recommending that the council increase the city's payments directly to CalPERS.

   The City has created a Pension Prefunding 115 Trust account and is in the process of developing a policy. The City staff concurs with the recommendation and will perform an analysis of the two options: (a) prefunding the 115 Trust account versus (b) prefunding directly to CalPERS. The analysis will be presented to the City Council with a recommendation in spring of 2023.

5. To improve the city's ability to pay other post-employment benefits, Richmond should, by June 2023 and annually thereafter, implement a policy identifying funds, such as surpluses or one-time revenues that should be contributed to the OPEB trust fund. Staff should conduct an annual analysis to determine whether any funds available to the city are

applicable under the city's policy and should present a proposal to the city council to apply those funds to the trust fund.

The City's FY2021-22 OPEB Policy requires a transfer of 50 percent of the operating surplus and one-time revenues into the OPEB trust ("trust") after meeting the minimum required General Fund reserve level. In the past, the City did not meet the minimum reserve policy targets, hence no additional contribution other than the Actuarially Determined Contributions (ADC) were made into the trust. The City is estimating to contribute $6.1 million at the end of FY21-22 into the trust. It is also important to note that the City's OPEB Unfunded Actuarial Liability has been decreasing and the funded status has improved in recent years. The Actuarial report as of June 30, 2022, represents a decrease of $19.3 million in unfunded liability from the prior year. ①

6. To mitigate the costs of increasing salaries, the city should perform a workforce analysis by June 2024. Based on the results of the analysis, the city council should consider eliminating vacant positions that it deems no longer necessary. Additionally, the city should assess its need for each vacant position before it seeks to fill the positions and eliminate any positions that it does not need.

   The City has recently completed a Classification and Compensation Study and in the process, several classifications have become obsolete and are proposed to be eliminated. The City staff will continue to conduct vacancy analysis and consider eliminating vacant positions, wherever possible, to achieve fiscal sustainability while maintaining service levels to the community. Currently, the City is taking a measured approach in filling the vacant positions.

7. To ensure compliance with federal requirements, Richmond should dedicate the resources necessary to provide records needed for an independent auditor to complete all outstanding single audits of the housing authority within the next fiscal year. To comply with existing legal obligations, Richmond should make available sufficient resources to enable the Housing authority to resolve all past due requirements of the recovery agreement and to meet the remaining deadlines in a timely manner by January 2024.

   The City has a long history of supporting programs to assist in developing affordable housing, including providing support to the Richmond Housing Authority (RHA) to help address its outstanding obligations. Unlike former times, RHA has an Executive Director, Senior Development Project Manager, Senior Property Manager, Building Maintenance Supervisor, Administrative Aide, Senior Resident Housing Manager, and Resident Housing Manager positions. Additionally, the City supports RHA through a Senior Accountant and Accountant I housed in the City's Finance Department. The Finance Department and the City also support RHA through all forms of administrative support such as, financial management, Information Technology, Human Resources, and the City Manager's Office.

8. To define Richmond's responsibility related to the housing authority, Richmond should immediately enter into a written agreement with the housing authority defining each

entity's financial responsibilities and draft plans to resolve past tax liabilities and prevent unnecessary new liabilities.

The City staff is in the process of creating an agreement defining financial and tax responsibilities between the two entities, the City of Richmond and the Richmond Housing Authority. The City Council provides policy direction to balance the needs of all the entities which rely upon its resources.

9. To ensure that Richmond is receiving the best value when entering into contracts, city staff should immediately begin documenting that they are following the contracting requirements in the city's municipal code and contracting policies for all contracts.

   The City staff is analyzing and updating current procedures based upon best practices and will follow the contracting requirements in Richmond's Municipal Code and contracting policies.

10. To reduce potential errors and omissions by city staff members when contracting for goods and services, by January 2023 Richmond should require its finance department to create a comprehensive checklist of required documentation for contract files that other departments must follow when conducting procurements.

    The City staff has commensed compilation of a comprehensive checklist that will be utilized in reviewing and approving all contracts to ensure that proper procurement procedures and adherance to all applicable City policies are followed.

11. To ensure that city fees appropriately cover the cost of providing services, by June 2023, Richmond should determine a cost-effective frequency for updating its fee schedule to reflect all allowable costs, including adjusting fees for inflation as appropriate. Richmond should then revise its municipal code as necessary.

    The City staff will update the Richmond Municipal Code to indicate that the Master Fee Schedule should be updated annually and as-needed (rather than quarterly), at least by the Employment Cost Index (ECI). A comprehensive fee study shall be done every three to five years.

Again, we appreciate the efforts you have taken to assist in improving the City's financial operations. The City staff are moving expeditiously to address your recommendations and we expect you will find continuing progress in the future.

Sincerely,

Shasa Curl
Richmond City Manager

cc: Mayor Butt and Members of the Richmond City Council
David J. Aleshire, City Attorney (Partner, Aleshire & Wynder, LLP)
Nickie Mastay, Deputy City Manager
Delmy Cuellar, Director of Finance

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE CITY OF RICHMOND

To provide clarity and perspective, we are commenting on Richmond's response to the audit. The number below corresponds to the number we have placed in the margin of Richmond's response.

The city's assertion that, in the past, it did not meet minimum reserve policy targets does not align with its financial reports and policies. Richmond's fiscal year 2020–21 reserve policy identified several types of funds that the city considered part of its reserve. Based on this policy, the city exceeded its fiscal year 2020–21 reserve target and may have been able to contribute up to $6.5 million to its OPEB trust fund. However, as we indicate on page 19, city staff did not conduct a thorough analysis of whether—under its then existing policy—these funds should have been placed in its OPEB trust fund and thus the city may have missed an opportunity to shore up this area of financial risk. 1